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No. 70-79

In the Supreme Court of the United States

OCTOBER TERM, 1971

RELIANCE ELECTRIC COMPANY, PETITIONER

v.

EMERSON ELECTRIC COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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Subsequent to the submission of our main brief, Gulf & Western Industries, Inc. ("Gulf & Western") moved to file an *amicus curiae* brief on the question whether the purchase by which a person becomes a 10 percent beneficial owner is to be included within the coverage of Section 16(b) as the first of a pair of transactions of purchase and sale occurring within the six-month period. Although apparently agreeing with the parties that this issue is not before the Court—it was decided by the court below in favor of petitioner Reliance Electric Company and respondent Emerson Electric Company did not cross-petition for

448-714—71

certiorari—Gulf & Western has submitted its brief on the ground that the discussion of the issue in our main brief invites this Court to adjudicate it.

While we agree that Section 16(b)'s application to Emerson's initial purchase of Dodge stock need not as such be resolved by this Court, a comprehensive analysis of all the insider abuses that Section 16(b) was designed to curb and a determination whether Emerson's two sales of Dodge stock could have enabled Emerson to profit from such abuses requires that some consideration be given to the "purchase" component of the exemptive provision of the statute. Since the starting point of such an analysis is the legislative history of Section 16(b) and its exemptive provision and since Gulf & Western has inaccurately portrayed that legislative history, we deem it appropriate to file this response.

1. In our main brief (pp. 29–32), we expressed the view that the exemptive provision in Section 16(b) evidences a legislative intent to accord different treatment to 10 percent beneficial owners than to officers and directors, in recognition that, while the latter can become statutory insiders only by voluntarily assuming the position of officer or director of a corporation, a 10 percent beneficial owner may attain or lose such statutory insider status by events other than a purchase or sale of stock. On this basis, we urged a construction under which the exemption would not be applicable in situations where insider status is acquired or lost by a stock purchase or sale, but instead would be applicable only in situations where, for ex-

ample, a person's stockholdings in a corporation are increased to more than 10 percent through the purchase by the corporation of part of its outstanding securities or through an acquisition of stock (other than by purchase) incidental to service as a fiduciary. In support of our position, we noted (pp. 32–34) that H.R. 8720, 73d Cong., 2d Sess., a substitute bill containing the exemptive provision for beneficial owners, was introduced in the House (on March 19, 1934) shortly after specific criticism was expressed at the Senate hearings (on February 28, 1934) concerning the adverse effect the initial draft of Section 16(b) might have upon executors, trustees and other fiduciaries.[1] This adverse effect on fiduciaries, arising from the possible attainment of 10 percent beneficial owner status through acquisition of stock other than by purchase, is simply an example of the adverse effect Section 16(b), absent the exemptive provision, would have on beneficial owners generally.

Gulf & Western, however, disputes our view. It contends that the legislative history of Section 16(b) demonstrates that the exemption for beneficial owners could not have been in response to the criticism concerning fiduciaries expressed at the Senate hearings, and thus was not intended to deal with problems of

[1] In attributing a direct connection between the inclusion of the exemptive provision in H.R. 8720 and the criticism expressed at the Senate hearings, we gave recognition to the fact that the Senate and House draftsmen were coordinating their efforts. See Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess., pp. 82–83.

fiduciaries, since that exemption "was not included in any Senate draft" of Section 16(b) (Br. 10). Specifically, Gulf & Western states that the exemptive provision, although contained in the House bill (H.R. 8720), did not appear in S. 3420, 73d Cong., 2d Sess.,[2] a substitute bill introduced in the Senate at the close of the Senate hearings at which Section 16(b)'s effect on fiduciaries was discussed. Contrary to Gulf & Western's contention, however, S. 3420, like H.R. 8720, did contain the exemptive provision for beneficial owners which now appears in the statute.[3]

2. Gulf & Western next attempts to explain the different treatment which the exemption accords 10 percent beneficial owners on the basis of a distinction which attributes both access to inside information and manipulative ability to officers and directors, but only access to information to large shareholders.

Specifically, Gulf & Western argues (Br. 12–13) that it was the House version of Section 16(b) that was ultimately enacted into law, and that, although the Senate apparently viewed its draft of Section 16(b), contained in S. 3420, as designed both to deal with unfair use of inside information and to prevent insiders from manipulating the financial affairs of their corporations, the House, on the other hand, con-

[2] S. 3420 was introduced in the Senate on April 20, 1934, not on April 27, 1934, as stated by Gulf & Western. See 78 Cong. Rec. 6980.

[3] Gulf & Western's mistaken belief that the exemption did not appear in S. 3420 is apparently based on the notion that S. 3420 was reprinted in full text in S. Rep. No. 792, 73d Cong., 2d Sess. That report, however, contained only a summary of the bill by sections and did not reprint the text of the bill. See S. Rep. No. 792, 73d Cong., 2d Sess., pp. 14, 20–21.

sidered its version of the statute as principally a means to combat the unfair use of inside information (Br. 10, 11). Based on the assumption that the exemption for beneficial owners appeared only in the House version of the statute, Gulf & Western concludes that the exemption, as enacted, was intended to exclude 10 percent beneficial owners from the purview of whatever antimanipulative effect Section 16(b) was designed to have.

Gulf & Western's entire analysis, however, rests on a series of erroneous assumptions and conclusions. First, as we have pointed out, both S. 3420 and H.R. 8720, contained the exemptive provision. Gulf & Western also is in error in stating that the preamble of Section 16(b), setting forth the statutory purpose as the prevention of unfair use of inside information, was contained only in the House version of the bill and thus reflected a narrower view by the House with respect to the statute's antimanipulative purpose. In fact, a preamble also was contained in S. 3420, where it appeared in the precise language of Section 16(b) as finally enacted. Moreover, there is no inconsistency between the statutory purpose set forth in the preamble and the concept that Section 16(b) was intended to prevent corporate manipulation by insiders. A person's knowledge that he will manipulate a corporation's affairs is no less information that Congress intended to deal with in Section 16(b) than his knowledge of what the corporation plans to do.

Also inaccurate is Gulf & Western's suggestion that only the Senate considered the problem of manipulation of corporate affairs by insiders, including large

shareholders.[4] Floor debates in the House on an amendment to delete the term "five percent beneficial owner" from Section 15 of H.R. 9323, 73d Cong., 2d Sess.,[5] demonstrate that the House was, in fact, acutely aware of the manipulative ability of large shareholders of corporations, recognizing that "a man who owns a large amount of stock, but nothing like a majority, controls the directors of the corporation," (78 Cong. Rec. 8037) and that "a great many large [stockholders * * * who are not officers * * * dictate the policies of the corporation." (78 Cong. Rec. 8038). The House view as to the manipulative ability of large shareholders was aptly summarized by Representative Rayburn, the sponsor of the legislation and Chairman of the Com-

[4] Gulf & Western has suggested (Br. 12) that even the Senate was confused in its discussion of Section 16(b) as an anti-manipulation provision, claiming that manipulative abuses were dealt with, not by Section 16(b), but by Sections 9 and 10 of the Act, 15 U.S.C. 78i and j. Section 9, however, is directed primarily toward manipulative practices in connection with the trading process itself. It does not deal with the manipulation of corporate financial policies as such. Moreover, the fact that the type of manipulative abuses covered in Section 16(b) is also subject to the proscriptions of Sections 9 and 10 "is neither unusual nor unfortunate." *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 468.

[5] H.R. 9323, a substitute bill revising H.R. 8720, was passed by the House and, together with a considerably different version passed by the Senate, was referred to a committee of conference which reported out a conference bill that ultimately was enacted into law. Section 15 of H.R. 9323 did not contain a short-swing profit provision. It did, however, contain provisions for the reporting of transactions by insiders and for the prohibition of insider short sales, identical to Sections 16(a) and (c) of the Act, 15 U.S.C. 78p(a) and (c), except that the statutory ownership requirement in H.R. 9323 was 5 percent.

mittee that conducted hearings on both H.R. 7852 and H.R. 8720, as follows (78 Cong. Rec. 8038):

> A while ago we passed a provision relating to manipulation, one of the finest in the bill. In my opinion, we are now considering another very important antimanipulative section.
>
> * * * We * * * know * * * that in the case of any corporation having widely scattered stockholders the concentration of 5 or 10 or 20 or 30 percent of stock ownership is control; they can always get the proxies.
>
> * * * [What we have here] is a man, however, who says: "I do not want to be an officer or a director for the reason that if I accept such office I am held under this provision. I can, however, be the largest stockholder in the company and by proxy and otherwise dominate the officers, the directors, and the policies of the company * * *. I will not, therefore, allow myself to be elected an officer; I will not allow myself to be elected a director; but I will stay on the outside, I will control the company, I will manipulate its stock up and down. When it is the proper time to run the market up * * * I will run it up; when it is to my interest to run the market down I will have the power to run it down."
>
> * * * * *
>
> Mr. Chairman, I think it would be most unfortunate to let out the man who in the last analysis, in my opinion, really controls the corporation.

Finally, even if it were assumed that the House version of Section 16(b) in H.R. 8720 reflected a determination to exclude large shareholders from the statute's antimanipulative impact, Congress, contrary to Gulf & Western's assertion, enacted the Senate version of the statute.[6]

[6] Section 16(b) of S. 3420, unlike the corresponding provision in H.R. 8720, is identical to Section 16(b) of the conference bill that was passed by Congress, except that the conference bill contained a statute of limitations clause. *Compare* Section 16(b) of S. 3420 and Section 15(b) of H.R. 8720 *with* Section 16(b) of the conference bill set forth in H. Rep. No. 1838, 73d Cong., 2d Sess., pp. 16–17. Indeed, the conference report which accompanied the bill expressly states that the conferees incorporated the Senate version of the statute into the conference bill. H. Rep. No. 1838, 73d Cong., 2d Sess., pp. 35–36. See *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 237 (C.A. 2), certiorari denied, 320 U.S. 751.

CONCLUSION

For the foregoing reasons and for the reasons set forth in our main brief, the judgment of the court of appeals should be reversed in so far as it exonerates Emerson from liability under Section 16(b) for the profits realized upon its second sale of Dodge stock.

Respectfully submitted.

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